Our Bank of England Decision Day Guide

Will the Bank of England bring an August rate hike firmly back into play? Here's what our team will be looking out for at today's meeting

In this bundle

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Bank of England: Crib Sheet for May meeting

Expect the Bank of England to buy itself more time as it keeps a watchful eye on the cracks appearing in the retail sector

No hike this month but an August rate rise looks likely

It's been a bit of a rollercoaster ride for UK rate hike expectations over the past couple of months. But in the end, we think the Bank of England will err on the side of caution and keep rates unchanged when it meets on Thursday. After all, a rate hike now could be one headwind too many for the faltering consumer-facing sectors.

But assuming the situation in retail doesn't get any worse between now and August, we think a rate hike over the summer still looks likely. With wage growth continuing to accelerate and global growth still (largely) heading in the right direction, we think policymakers are unlikely to have changed their minds when it comes to the prospect of further tightening. The Bank will also be conscious that Brexit noise could make it complicated to hike rates later in the autumn.

Markets are currently pricing a 50:50 chance of an August move, and there is a possibility that the Bank tries to subtly boost expectations. While we doubt we'll see any direct comments about the curve being too low this time, watch out for what the Bank has to say on growth, Brexit and wages, for signs that it is gearing up for further tightening in the months ahead.

Here's what we expect from the May meeting.

Four Bank of England scenarios for the May meeting

	Bank of England view/comments					
Scenario (More hawkish ↓)	No. of rate hike votes	Growth	Inflation/Wages	Brexit progress	Rate hike path	Market impact
1 No rate hike Big rethink	0 Hike votes	Big outlook reassessment. Global growth slowing, consumer caution to persist	Core inflation set to fall more sharply; wage growth could be slower	Reintroduces language that there are "considerable risks" to the outlook	Removes signal that "ongoing tightening" required over "forecast period"	EUR/GBP +1.25% GBP/USD -1.75%
ING base case: 2 No rate hike Buying more time	2 Hike votes	Lower near-term growth forecast. Partly snow, but also lower consumer/ Eurozone growth	Lowers inflation forecasts a touch, but still looking for strong wage growth this year	Notes recent transition agreement, but restates Brexit is a "significant" uncertainty	Reiterates that "gradual" rate hikes are needed, but offers nothing more specific	EUR/GBP -0.25% GBP/USD +0.75%
3 Rate hike Stick to the plan	7 Hike votes	Factors driving weakness largely temporary. Risk of upward revision to 1Q GDP	Still expects 3% wage growth, cites evidence from Agents of sharper pay rises	Transition period "reduces likelihood" of disorderly Brexit, should "support" confidence	Hints could hike more than once in 2018. Doesn't say explicitly that market pricing is too low	EUR/GBP -1.75% GBP/USD +2.00%
4 Rate hike Full speed ahead	9 Hike votes	Factors driving 1Q weakness were all temporary (e.g. snow). Expects full rebound	Upside risks to wage growth. Sees risk of persistently above-target inflation	Upgrades medium-term growth profile following transition agreement	Tightening to be greater & earlier. Rates need to rise faster than markets expect	EUR/GBP -2.00% GBP/USD +2.25%

Source: ING, GBP forecasts from our FX Strategy team

Cracks appearing in consumer-facing sectors give reason for pause

As the Bank of England prepares to meet next week, it'll be well aware that hiking in the aftermath of the weakest quarterly growth reading since 2012 would be a tough sell. Admittedly some of the causes of the slowdown were temporary – multiple bouts of snow saw construction activity make an unusually large negative contribution to first quarter GDP. It's possible some of this gets revised up – and it'll be interesting to see if the Bank agrees on Thursday.

But the cracks appearing in consumer-facing sectors look more concerning. The perfect storm of weaker demand, higher business rates and rising minimum wage costs resulted in one of the worst quarters for retail since the financial crisis. A rate hike now might prove to be one headwind too many for retailers, many of whom have become highly leveraged in the post-crisis years. And things aren't set to get much better immediately - real incomes remain pressured by higher fuel and food costs (albeit the worst of the household squeeze has passed).

Alarmingly, consumer credit growth appears to have collapsed in recent months, with banks reportedly scaling back loan availability significantly. This may prove to be a blip, but we suspect the Bank will want to buy time until the underlying drivers of this rapid downfall become clearer.

Unlikely the Bank's pause this month will turn into a permanent hiatus

Away from the activity story, the major drivers underpinning the Bank's recent tightening bias have remained largely on track. The prospects for global growth still look relatively bright, despite the recent moderation in Eurozone activity. Similarly, wage growth has continued to outperform over the last few months, giving policymakers greater confidence that skill shortages in the jobs market are boosting pay. Bank agents have indicated that this could be the best year for pay settlements since the crisis.

Policymakers will also be acutely aware that their window to hike rates could close soon. If the build-up to the December and March EU leader's meetings is any guide, the months leading up to the October summit could see negotiations get increasingly noisy. At the same time, we expect to see core inflation fall back to target over the summer, given that prices have now virtually adjusted to the new value of the pound. This has seen inflation fall noticeably faster than the Bank of England was forecasting back in February.

These two factors could complicate efforts to hike rates as we get later into the year, and we think the Bank will be keen to capitalise while they can. Assuming that the faltering consumer sector doesn't deteriorate further, we think there's still a good chance the Bank will hike again in August.

Find out why we still think the longer-term direction for sterling is up

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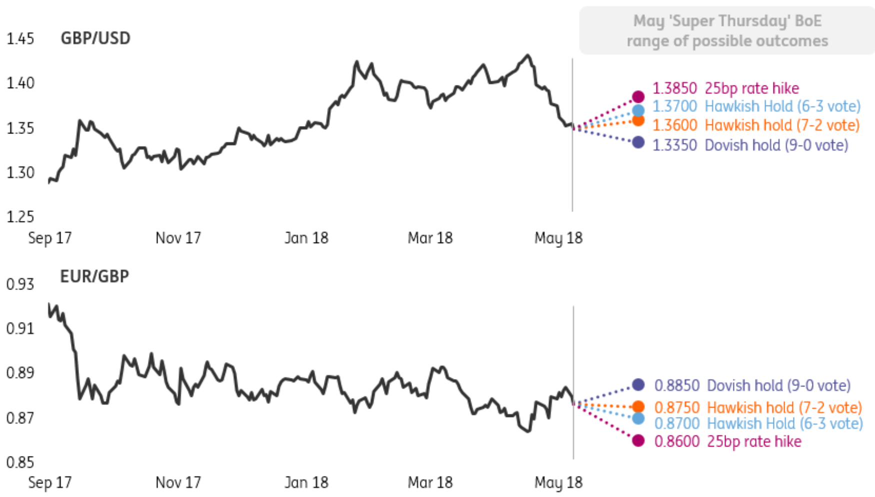
British pound and the Bank of England: Carney's chameleon act

While the prospect of a May Bank of England rate hike will most likely come and go at this week's meeting, what matters for the pound is whether...

Source: Source: Bank of England

GBP outcomes to possible May BoE meeting scenarios

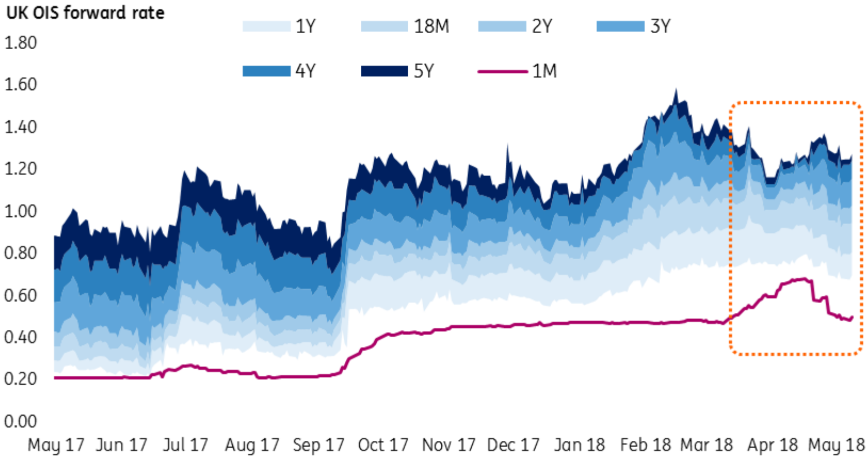


Source: ING estimates, Bloomberg

Key takeaways

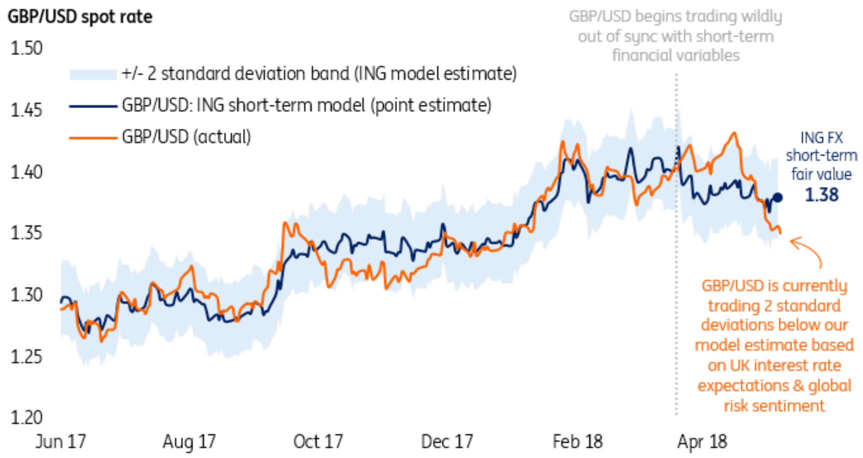
- The pound's sharp rise and fall over the past month should be a warning shot to the Bank of England that markets are still struggling to get to grips with their policy reaction function in a post-Brexit world. Hence, what policymakers choose to signal at the May 'Super Thursday' meeting could set the tone for GBP markets over summer.
- Recent wild swings in GBP are somewhat indicative of an "all or nothing" sentiment when it comes to further BoE rate hikes ("all" being two or more rate hikes in 2018 versus "nothing" being that the Bank will not hike again). There is a middle ground, which we expect to be reiterated at the May meeting; the combination of a 7-2 split MPC vote (two rate hike dissenters), the Bank downplaying the soft 1Q GDP data and a reiteration by Governor Carney that another rate hike this year remains "likely". This should be enough to provide a modest uplift to short-term UK rates following the recent scaleback – or at the very least keep the curve supported where it currently sits.
- The decline in GBP/USD to 1.35 looks overcooked relative to the more tempered BoE policy rate expectations. This – coupled with cleaner positioning and relatively limited sentiment for additional downside – means that we think the risk-reward favours GBP/USD upside going into the May BoE meeting. Signs that the BoE tightening cycle remains intact could lift GBP/USD up towards 1.3600 – while keeping EUR/GBP supported around 0.8750.
- As our economists outline, we do see tail risk outcomes on either side. A subtle hawkish surprise for GBP markets would be a 6-3 MPC split vote, which would give greater support to an August BoE rate hike (currently 50% priced in). An additional hawk joining the rate hike dissenters (with Chief Economist Any Haldane or external MPC member Gertjan Vlieghe the most likely candidates) may also give greater conviction to the MPC's medium-term hawkish bias – especially with resident hawk Ian McCafferty's term coming to an end after the August meeting. A 6-3 MPC split vote scenario (with three rate hike dissenters) could see GBP/USD moving up towards 1.3700
- **Bottom line:** We think GBP's fall in recent weeks - especially against the USD - looks overdone relative to the adjustment that we've seen in short-term UK rates. We remain medium-term GBP bulls, though acknowledge that the short-term outlook will be a function of what the BoE chooses to signal at the May policy meeting and 2Q UK economic data outturns. Should policymakers keep the prospect of a 2018 rate hike on the table this week, then we would expect signs of a 2Q rebound in UK economic activity to lift GBP/USD up towards 1.40 by end 2Q18 – with EUR/GBP resilient around 0.87-0.88 amid a recovering EUR.

Market expectations: Curve adjusted to May rate hike rise and fall... all eyes on August now



Source: ING, Bloomberg

Dissecting the Rise and Fall: GBP's decline looks overcooked relative to the adjustment in UK rates



Source: ING estimates, Bloomberg

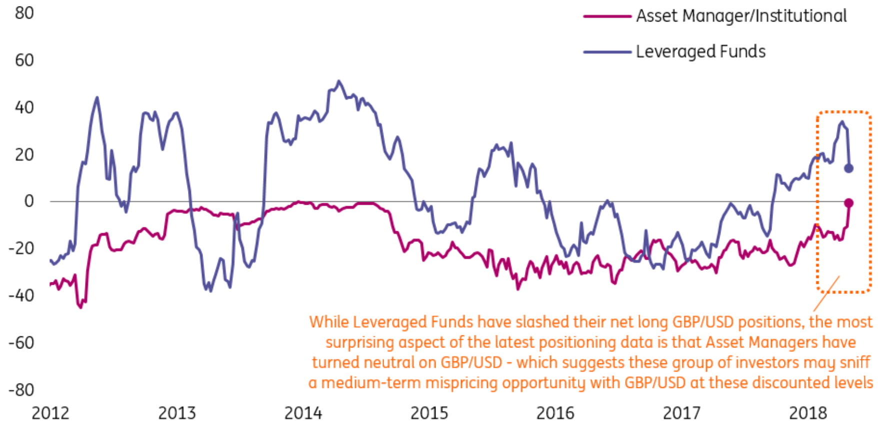
GBP positioning: Shaken but not stirred

Fast-money investors (leveraged funds) have, as expected, slashed their net long GBP/USD positions in half over the past few weeks – as odds of a May Bank of England rate hike have receded and USD sentiment has recovered. But the most surprising element of the latest CFTC positioning data is that asset managers have turned neutral on GBP/USD for the first time since summer 2014. This suggests one of two things to us:

- Some institutional investors sniff a bullish opportunity with GBP/USD at these depressed levels and/or
- These group of investors overall no longer see scope for much further downside in GBP/USD. While the underlying breakdown shows tentative evidence for both factors at play, the former has greater substance given asset manager long GBP/USD positions increased from 13.6% to 21.6% (the highest since Dec 2008). A reassessment of UK political risks may be more of a driving force here for these medium-term investors, though we'll need to see whether this is more than just a quirk in the positioning data.

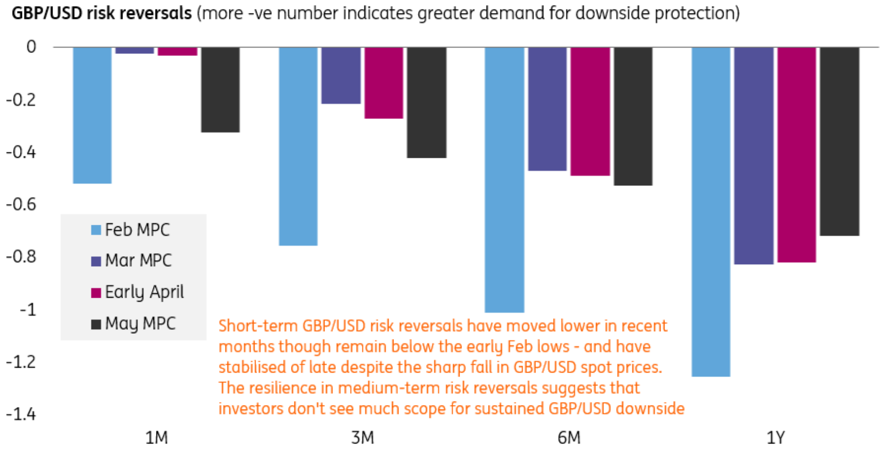
For this week at least – and given the greater link between leveraged funds positioning and BoE policy sentiment – we think Governor Carney's reiteration that another rate hike remains likely this year should put a backstop to any further GBP positioning adjustment. Instead, the much cleaner positioning means that GBP/USD is more vulnerable to a sharper rebound in the event of a hawkish surprise (ie, a 6-3 vote MPC split).

GBP/USD net positioning (% of open interest)



Source: ING, Macrobond, CFTC. Note: Positioning data as of 01 May 2018

GBP sentiment: Consolidation in risk reversals suggests limited scope for further downside



Source: ING, Bloomberg

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